



*Taxpayer Payments Were Improperly
Transferred to the Excess Collection File*

March 2, 2011

Reference Number: 2011-30-020

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

- 1 = Tax Return/Return Information
- 3(d) = Other Identifying Information of an Individual or Individuals



HIGHLIGHTS

TAXPAYER PAYMENTS WERE IMPROPERLY TRANSFERRED TO THE EXCESS COLLECTION FILE

Highlights

Final Report issued on March 2, 2011

Highlights of Reference Number: 2011-30-020 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Taxpayer payments that cannot be applied to the proper taxpayer account are transferred to the Excess Collection File (XSF). The Internal Revenue Service (IRS) did not always properly document and approve requests for transfers or adequately notify taxpayers of their right to have payments refunded before it transferred the payments to the XSF. When this situation occurs, there is an increased risk that taxpayers will not recover their payments.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the IRS is properly managing and processing excess collections. This was a followup review to previous TIGTA audits related to the XSF.

WHAT TIGTA FOUND

When research is required on a request for transfer to the XSF, the Excess Collections File Addition (Form 8758) should be fully completed to ensure credits are correctly added to the XSF. TIGTA reviewed a statistically valid random sample of 86 small-dollar cases with transfers between \$50,000 and \$100,000 and another random sample of 66 large-dollar cases in which the transfer to the XSF was more than \$1 million. TIGTA determined that the documentation was not sufficient in 135 (96 percent) of 140 requests (12 cases were not reviewable). TIGTA estimates that requests were not properly documented for 729 taxpayers with credits totaling more than \$604 million transferred from their accounts into the XSF.

Of the 66 cases in the large-dollar sample, 56 required managerial approval. However, for 13 (23 percent) of the 56 cases, managerial approval was not obtained. The absence of managerial approval may indicate that the managers are not reviewing the requests. TIGTA estimates that 26 taxpayers had credits of more than \$145 million transferred to the XSF with no managerial approval.

Taxpayers who submit a payment of tax when the IRS is barred from making an assessment must be refunded their payment if they make a timely claim for refund. However, TIGTA determined that, in general, this was not occurring. Taxpayers were not adequately notified because the letter required to be issued to taxpayers was sent to only 6 of 37 taxpayers. Also, the letter does not provide the taxpayer with sufficient information about how to claim a refund. TIGTA estimates that 224 taxpayers, involving more than \$116 million, were not adequately notified of their right to receive a refund.

WHAT TIGTA RECOMMENDED

TIGTA made several recommendations to the Directors, Submission Processing and Accounts Management, Wage and Investment Division, to improve the guidance and forms associated with the XSF program to ensure more consistent processing, approval, and communication with taxpayers.

IRS officials agreed with our recommendations and are planning corrective actions. The IRS plans to revise the guidance pertaining to transfers to the XSF for clarification and consistency and revise Form 8758 to include a line for managerial approval. Also, management plans to request a program change to systemically issue a letter for payments received after the assessment statute expiration date or with an amended return. Finally, the IRS plans to revise the letter to clarify how to claim a refund.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

March 2, 2011

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael R. Phillips
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Taxpayer Payments Were Improperly Transferred
to the Excess Collection File (Audit # 201030013)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) is properly managing and processing excess collections. The review was conducted as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Taxpayer Protection and Rights.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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Abbreviations

ASED	Assessment Statute Expiration Date
IDRS	Integrated Data Retrieval System
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
RSED	Refund Statute Expiration Date
XSF	Excess Collection File



Taxpayer Payments Were Improperly Transferred to the Excess Collection File

Background

The Excess Collection File (XSF) is a control file within the Integrated Data Retrieval System¹ (IDRS) containing nonrevenue receipts² and payments that cannot be applied to a taxpayer account. Payments that eventually go to the XSF are generally caused by one of a limited number of conditions, such as:

- A taxpayer submits a tax payment but does not file a tax return.
- A taxpayer files a tax return past the time period to receive a refund.
- A taxpayer submits a tax payment in anticipation of a tax adjustment, but the adjustment does not occur.
- The Internal Revenue Service (IRS) is unable to determine which taxpayer's account to apply a payment.

After a payment is moved to the XSF, it is no longer associated with the taxpayer's account. As of January 2010, there was approximately \$4.7 billion in the XSF, and more than \$1.4 billion (30 percent) of this amount came from transfers of \$50,000 or more.

Most transfers to the XSF originate in the Wage and Investment Division's Accounts Management function or the Statute area within the Accounts Management function. When payments and the associated documents are not received or processed as expected, the Accounts Management function at each IRS campus³ is responsible for ensuring resolution. If the case is still not resolved after the Accounts Management function research has been performed and the payment is more than 1 year old, the payment is transferred to the XSF. The Statute area reviews statute imminent/expired cases related to the original returns and payments. The Statute area also reviews amended returns when the amended return reflects an increase in tax and documents that are rejected for statute imminent or expired periods. Both the Statute area and Accounts Management function fill out Excess Collections File Addition (Form 8758) requests to transfer a credit from the taxpayer's account to the XSF and to support the research conducted by the requester.

¹ IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

² Nonrevenue receipts are received for items other than taxes (e.g., bulk forms, photocopy fees, court fines, and installment user fees).

³ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



Taxpayer Payments Were Improperly Transferred to the Excess Collection File

The Excess Collection function is responsible for ensuring requests for transfers to the XSF are complete and fully documented. Before adding credits to the XSF, accounting technicians are required to review Forms 8758 to ensure the completeness of data, prior research, and statute barred criteria, as well as proof that the credits are available.

The Treasury Inspector General for Tax Administration has reviewed the XSF three previous times, issuing the most current report⁴ in Fiscal Year 2005. In response to that report, the IRS formed the Excess Collection File Task Group. This Task Group concluded that the XSF process relied almost exclusively on notices and letters with relatively few instances in which personal contact was made with the taxpayer. A major change resulting from the Task Group was to require employees to conduct additional research on large dollar (\$100,000 or more) credit balance accounts prior to moving funds to the XSF, including a new requirement to make telephone contact with the taxpayer.

This review was performed in the Wage and Investment Division's Headquarters Office in Atlanta, Georgia, and the Customer Account Services function at the Philadelphia Campus in Philadelphia, Pennsylvania, during the period February through August 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁴ *Enhancing Internal Controls for the Internal Revenue Service's Excess Collections File Could Improve Case Resolution* (Reference Number 2005-30-022, dated January 21, 2005).



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Results of Review

Transfer Requests to the Excess Collection File Are Not Always Prepared Properly

To determine whether transfer requests to the XSF were appropriate, we selected a statistically valid sample of 86 small-dollar cases (\$50,000 to \$100,000) involving individual taxpayers and another random sample of 66 large-dollar cases involving individual and business taxpayers in which the transfer to the XSF was more than \$1 million. We reviewed the Forms 8758 and any supporting documentation pertaining to the sampled cases.

The results of our sampled case reviews showed that Forms 8758 were not always completed in compliance with established procedures. Specifically, we determined the following:

- Transfer requests were not always properly documented.
- Transfers of \$1 million or more did not always have managerial approval.
- Reviews of Forms 8758 by the Excess Collection function were not effective.

Transfer requests were not always properly documented

Internal control standards require that agencies establish control activities that ensure management's directives are enforced and carried out.⁵ The standards require that all transactions and other significant events be clearly documented and that the documentation be readily available for examination. All documentation and records should be properly managed and maintained. Proper documentation provides support for the transfer of taxpayer credits to the XSF.

When research is required on a credit request for transfer to the XSF, the Internal Revenue Manual (IRM) requires a Form 8758 to be fully completed.⁶ Form 8758 must include support for all command codes⁷ researched, any Internet research conducted, and any attempted taxpayer contact including letters sent and telephone calls made, as well as documentation supporting the availability of the credit. See Appendix V for an example of a properly documented Form 8758.

⁵ *Standards for Internal Controls in the Federal Government* (Reference Number GAO/AIMD-00-21-.3.1, dated November 1999).

⁶ Some cases involve automatic batch transfers to the XSF and research is not required.

⁷ Command codes consist of five letters and are used to research taxpayer information on the IDRS.



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For 148 (97 percent) of the 152 requests for transfer in our 2 samples, the IRS was required to perform research prior to transferring the credit to the XSF. However, we determined that the documentation was not sufficient in 135 (96 percent) of 140 requests.⁸ The 135 cases⁹ involved more than \$303 million in credits transferred to the XSF and contained the following documentation errors:

- In 129 (92 percent) of the 140 cases, the Form 8758 did not include proper documentation that contact with the taxpayer was made (or attempted). Form 8758 provides space to document any letters sent to the taxpayer. For example, when a credit is transferred to the XSF because the IRS is barred from making an assessment¹⁰ on a payment received from the taxpayer, proper documentation on the Form 8758 should show that the taxpayer was sent an Assessment Statute Expiration Date (ASED) Expired (Letter 2765C). Letter 2765C advises the taxpayer that the period of time for the IRS to make an assessment has passed and that the taxpayer has 2 years from the date of the payment to submit a claim to have the payment refunded.
- In 38 (27 percent) of the 140 cases, the Form 8758 documented the command codes used when researching the credit, but did not include the required printouts of the IDRS command codes researched or a summary of the analysis of the IDRS research. For every transfer to the XSF, proper documentation attached to the Form 8758 should support the availability of the credit on the taxpayers' accounts. IDRS printouts are also required to support the Refund Statute Expiration Date¹¹ (RSED) or ASED,¹² and the filing date (statute criteria).

An accurate, complete, and properly documented Form 8758 ensures credits are correctly added to the XSF. Without proper documentation, management does not have evidence to determine if the actions taken on the cases were appropriate. Based on our sample results, we estimate that between January 15, 2006, and January 15, 2010, requests were not properly documented for 729 taxpayers with credits totaling more than \$604 million transferred from their accounts into the XSF.

Transfers of \$1 million or more did not always have managerial approval

Beginning January 1, 2007, XSF requests for credit transfers of \$100,000 or more require managerial approval on Forms 8758. This requirement was intended to ensure that the proper

⁸ Of the 148 cases requiring research, the Form 8758 was not available for 8 cases in our sample, leaving 140 cases requiring research that were reviewable.

⁹ Thirty eight (38) cases had more than 1 documentation error.

¹⁰ The IRS may not assess additional taxes (i.e., is barred) after a certain period of time has passed (i.e., the statute of limitations).

¹¹ The RSED is based on the period of time for which a taxpayer may file a claim to receive a refund for tax payments that exceed tax liabilities.

¹² The ASED is based on the period of time for which the IRS may assess tax.



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steps are taken before large-dollar credits are transferred to the XSF. Of the 66 cases in our large-dollar sample, 56 were requested after January 1, 2007, thereby requiring the requestor to obtain managerial approval. However, we determined that for 13 (23 percent) of the 56 cases, managerial approval was not obtained. The 13 cases involved more than \$75 million transferred into the XSF.

During our review, the tax analyst who assisted us in obtaining the Forms 8758 for our sample cases recognized that transfers into the XSF of credits of \$1 million or more did not always have managerial approval. In April 2010, the tax analyst issued the following notice¹³ regarding large-dollar XSF cases:

Per IRM 3.17.220.2.1.2, large dollar cases of \$100,000.00 or more must have managerial approval of the originator notated on F8758 prior to the transfer to the Excess Collection File. Any F8758 for large dollar cases without managerial approval must be rejected back to the originator.

In addition, IRS procedures do not provide a specific method for notating approval, and Form 8758 does not include a dedicated location (such as a box or line) to notate managerial approval, which could help remind employees and managers of the need for it. Most of the 43 large-dollar sample cases that did have managerial approval were notated using a manager's signature, but the signatures were seldom in the same place on the forms.

The absence of managerial approval on these large-dollar cases may indicate that the managers are not reviewing the requests before they are submitted to the XSF. Based on our results, we estimate that between January 1, 2007, and January 15, 2010, 26 taxpayers had credits totaling more than \$145 million¹⁴ transferred from their accounts into the XSF with no managerial approval.

Reviews of Forms 8758 by the Excess Collection function were not effective

To ensure requests for transfers to the XSF are accurate, complete, and properly documented, XSF accounting technicians are required to review submitted Forms 8758 and all supporting documentation, when attached. The accounting technicians are required to reject Forms 8758 that are not compliant with the documentation requirements. They are also required to reject any Form 8758 requesting a transfer of a credit of \$100,000 or more when managerial approval is not notated. If a Form 8758 is rejected, it is sent back to the originator to be corrected. However, in

¹³ A Service-wide Electronic Research Program "ALERT" was issued, which disseminates information that may impact employees Service-wide, but does not require an IRM procedural update.

¹⁴ For our projection in Appendix IV, we calculated the error rate for those cases transferred to the XSF during the 12-month period ending January 15, 2010. We projected the error rate for the 6 (14 percent) of 43 cases transferred to the XSF during the 12-month period ending January 15, 2010, to the population of 57 transfers during that period, which resulted in 8 Forms 8758 and approximately \$37.3 million in transferred payments. We then projected this amount over the next 5 years, which totaled 40 Forms 8758 and more than \$186 million.





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Collection function accounting technicians. In addition, the revised IRM sections should clarify the reasons to reject Forms 8758 (lack of documentation and managerial approval on transfer requests of \$100,000 or more).

Management's Response: IRS management agreed with this recommendation and will revise the IRM sections to clarify the research required to add payments to the XSF and clarify the reasons to reject Forms 8758.

Recommendation 2: Request revisions to Form 8758 to include a dedicated line for managerial approval (signature) and date for all transfers of \$100,000 or more.

Management's Response: IRS management agreed with this recommendation and will revise Form 8758 to include a dedicated line for the manager's approval signature and date for all transfers of \$100,000 or more.

The Director, Accounts Management, Wage and Investment Division, should:

Recommendation 3: Emphasize the research and documentation requirements for transfers to the XSF and the requirement for managers to review and approve all transfers of \$100,000 or more.

Management's Response: IRS management agreed with this recommendation. The Accounts Management function will work jointly with the Submission Processing function to review the various IRM sections for consistency and will make revisions as needed. The Accounts Management and Submission Processing functions will also provide training on the IRM revisions, as needed.

Taxpayers Were Not Adequately Notified of Their Rights When Payments Were Transferred Because of a Barred Assessment

Statutes of limitations help protect taxpayers' rights by limiting the time in which the IRS can assess tax, refund credits, and collect taxes. Statute-related issues are complex, and actions taken against taxpayers regarding the statute of limitations require that adequate notification be given to the taxpayer.

The RSED includes a 3-year rule and a 2-year rule. The 3-year rule pertains to the time taxpayers have for certain prepaid tax payments such as estimated tax payments, Federal tax withheld from wages, and overpayments credited from prior tax years refunded when tax payments exceed the tax liability reported on the tax return. The amount to be refunded (or credited) is limited to the tax paid during the 3-year period prior to the filing of the original tax return, plus the period of any extension of time to file.

The RSED 2-year rule pertains to tax payments made after the tax return due date, which can be refunded (or credited) as long as the claim for refund is within 2 years of the payment date. If a



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taxpayer makes a payment, with or without a return, the taxpayer has the right to file a claim within 2 years of that payment for a refund (or credit another tax account).

The ASED is based on the time during which the IRS may assess tax, which is normally 3 years from the due date of the return or from the date the return is filed, whichever is later. The IRS is barred from making an assessment when the ASED has passed. If a taxpayer submits a payment of tax when the IRS is barred from making an assessment, the taxpayer must be refunded the payment if he or she makes a timely claim for refund (within 2 years of payment). If a taxpayer files an amended return when the IRS is barred from making an assessment, any amount paid with that return must be refunded if the taxpayer makes a timely claim for refund.

In 38 (25 percent) of 152 sampled cases, taxpayer payments were transferred to the XSF because the IRS was barred from assessment at the time the payments were received. **1, 3(d)*****
*****1, 3(d)*****. Specifically,

- 29 of the 37 taxpayers submitted more than \$53 million in total tax payments in anticipation of an adjustment due to an examination.
- 8 of the 37 taxpayers submitted approximately \$664,000 in total tax payments with an amended return after the ASED. Because the IRS was barred from assessment, the amended returns were not processed.

Our analysis *****1, 3(d)*****
*****1, 3(d)*****.

The request to transfer these payments to the XSF originated in the Statute area. The IRM sections pertaining to the Statute area require payments received after the ASED be transferred into the XSF. For those payments received with an amended return, the IRM also requires Letter 2765C be issued to the taxpayer. Letter 2765C advises the taxpayer that the time period for the IRS to make an assessment has ended and the taxpayer has 2 years to file a claim to have the payment refunded. However, we determined that a Letter 2765C was sent to only 6 (16 percent) of the 37 taxpayers.

The remaining 31 taxpayers (84 percent) were not adequately notified due to the following reasons:

- The IRM sections pertaining to the Statute area that address subsequent payments made in advance of an adjustment, but are received after the ASED, do not include a specific requirement to issue a Letter 2765C to the taxpayer.



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- The issuance of Letter 2765C must be done manually, unlike some other taxpayer correspondence that is done systemically (e.g., the ASFR Possible Refund Letter 2469C).¹⁵

Further, the six taxpayers who received Letter 2765C were not provided with sufficient information about how to claim a refund. Letter 2765C advises the taxpayer to file a claim for refund within 2 years from the date he or she paid the tax. However, the letter does not provide any information on how to file a claim. The taxpayer may be confused since a claim for refund is generally made on an income tax return or amended return, but these taxpayers had already filed their income tax returns. Claim for Refund and Request for Abatement (Form 843) can be used to file a claim for refund. However, Form 843 is not referred to in Letter 2765C.

Based on the results from the 36 taxpayers in our sample who did not file a claim for a refund, we estimate that between January 15, 2006, and January 15, 2010, 224 taxpayers were not adequately notified of their rights to have their payments refunded, involving more than \$116 million¹⁶ in credits transferred to the XSF.

Recommendations

The Director, Accounts Management, Wage and Investment Division, should:

Recommendation 4: Request programming changes to systemically issue Letter 2765C when taxpayers submit payments after the ASER in advance of an examination adjustment or with an amended return. In the interim, revise the respective IRM sections to instruct the issuance of Letter 2765C when payments are submitted after the ASER in advance of an examination adjustment.

Management's Response: IRS management agreed with this recommendation and will submit a Unified Work Request for programming changes to systemically issue a letter when taxpayers submit payments after the ASER, or with an amended return. In the interim, the IRS will clarify the existing procedures regarding the issuance of Letter 2765C.

Recommendation 5: Request revisions to Letter 2765C to clarify how to file a claim for refund and include Form 843 when Letter 2765C is sent to the taxpayers.

¹⁵ ASFR – Automated Substitute for Return. Letter 2469C informs the taxpayer a refund may be due if a return is filed within 3 years of the original due date.

¹⁶ For our projection in Appendix IV, we calculated the error rate for those cases transferred to the XSF during the 12-month period ending January 15, 2010. We projected the error rate for the 16 (27 percent) of 60 cases transferred to the XSF during the 12-month period ending January 15, 2010, to the population of 265 transfers during that period, which resulted in 72 taxpayers and approximately \$37.5 million in transferred payments. We then projected this amount over the next 5 years, which totaled 360 taxpayers with transfers more than \$187 million.



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Management's Response: IRS management agreed with this recommendation and will request a revision to Letter 2765C, clarifying how to file a claim for refund, and include Form 843 when Letter 2765C is sent to taxpayers.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS is properly managing and processing excess collections. To accomplish this objective, we:

- I. Evaluated IRS policies, procedures, goals, and monitoring of the XSF program.
 - A. Reviewed revisions to IRM procedures and other guidance issued.
 - A. Assessed the IRS's corrective actions in response to a prior Treasury Inspector General for Tax Administration audit report¹ by reviewing Joint Audit Management Enterprise System² documents and management responses to evaluate whether the corrective actions were timely and effectively implemented.
 - B. Assessed the IRS's corrective actions in response to the National Taxpayer Advocate's 2006 Annual Report to Congress to evaluate whether the corrective actions were effectively implemented.
- II. Obtained a computer extract from the XSF database as of January 15, 2010.
 - A. Validated the universe using the IDRS and the XSF inquiry command code and verified the accuracy of the computer extracts.
 - B. Selected a statistically valid sample of 66 transfers of more than \$1 million involving individual and business taxpayers, after January 15, 2006, from a population of all 127 in the excess collection database as of January 15, 2010. We used a statistical sample because we wanted to project the number of cases with errors. We used attribute sampling to calculate the minimum sample size (n),³ equal to 66.

$n = (Z^2 p(1-p))/(A^2)$	66
Z = Confidence Level:	95 percent (expressed as 1.96 standard deviation)
p = Expected Rate of Occurrence:	10 percent
A = Precision Rate:	±5 percent

¹ *Enhancing Internal Controls for the Internal Revenue Service's Excess Collections File Could Improve Case Resolution* (Reference Number 2005-30-022, dated January 21, 2005).

² The Joint Audit Management Enterprise System is the Department of the Treasury's automated audit tracking and management control system.

³ The formula $n = (Z^2 p(1-p))/(A^2)$ is from *Sawyer's Internal Auditing – The Practice of Modern Internal Auditing*, 4th Edition, pp. 462-464.



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1. Researched the actions taken for the payments using the IDRS and XSF case files to determine if sufficient actions were taken before transfer to the XSF.
 2. Determined whether Internal Revenue Code procedures are used during case resolution when the taxpayer is unable or unwilling to submit a tax return.
 3. Determined whether the required transaction code and action code were entered into the IDRS to conduct research prior to the transfer to the XSF for the cases in our sample for which credits were transferred after December 2006.
 4. Determined whether managerial approval was obtained for all payments more than \$1,000,000 transferred to the XSF.
- C. Selected a statistically valid sample of 86 individual payments between \$50,000 and \$100,000 from a population of 756 payments transferred to the XSF between January 15, 2006, and January 15, 2010. We used a statistical sample because we wanted to project the number of cases with errors. We used attribute sampling to calculate the minimum sample size (n), equal to 86.

$$n = (Z^2 p(1-p))/(A^2) \quad 86$$

Z = Confidence Level: 90 percent (expressed as 1.65 standard deviation)
p = Expected Rate of Occurrence: 10 percent
A = Precision Rate: ± 5 percent

1. Researched the actions taken for the payments using the IDRS and XSF case files to determine if the sufficient actions were taken before transfer to the XSF.
2. Determined whether Internal Revenue Code procedures are used during case resolution when the taxpayer is unable or unwilling to submit a tax return.
3. Determined whether the required transaction code and action code were entered into the IDRS to conduct research prior to the transfer to the XSF for the cases in our sample for which credits were transferred after December 2006.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the Wage and Investment Division's Accounts Management and Submission Processing functions' policies, procedures, and practices for transferring credits into the XSF, including documentation requirements and the requirement to obtain managerial approval on all transfers of \$100,000 or more. We evaluated these controls by selecting a sample from the XSF, analyzing accounts by using the IDRS, and reviewing applicable Excess Collections File Addition (Form 8758) requests.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Wage and Investment Division SE:W



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 360 taxpayers not adequately notified of their right to have tax payments totaling \$187.6 million refunded (see page 7).

Methodology Used to Measure the Reported Benefit:

We selected and reviewed 2 statistically valid random samples of XSF transfers involving 86 small-dollar cases (transfers of \$50,000 – \$100,000) for individual taxpayers and 66 large-dollar cases (transfers more than \$1 million) for individual and business taxpayers. The samples were selected from transfers to the XSF between January 15, 2006, and January 15, 2010, and based on a confidence level of 90 percent with a ± 5 percent precision level and an expected error rate of 10 percent. Overall, we determined that in 38 (25 percent) of 152 sampled cases, the IRS transferred payments to the XSF when it was barred from making an assessment. The 38 cases included 37 taxpayers, as 2 payments were from the same taxpayer. The IRS did not provide adequate notification on claiming a refund to these 37 taxpayers. For our projection, we calculated the error rate for those cases transferred to the XSF during the 12-month period ending January 15, 2010. We projected the error rate for the 16 (27 percent) of 60 cases transferred to the XSF during the 12-month period ending January 15, 2010, to the population of 265 transfers during that period, which resulted in 72 taxpayers and approximately \$37.5 million in transferred payments. We then projected this amount over the next 5 years, which totaled 360 taxpayers with transfers over \$187 million.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; ****1, 3(d)*****
*****1, 3(d)*****.

Methodology Used to Measure the Reported Benefit:

Using the same samples, we identified ****1, 3(d)*****
*****1, 3(d)*****,



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*****1, 3(d)*****
*****.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 40 Excess Collections File Addition (Form 8758) requests for the transfer of \$186.9 million to the XSF were accepted with no managerial approval (see page 3).

Methodology Used to Measure the Reported Benefit:

Using the same sample of large-dollar cases more than \$1 million, we determined that 56 cases required the requestor to obtain managerial approval. However, for 13 (23 percent) of the 56 cases, managerial approval was not obtained. For our projection, we calculated the error rate for those cases transferred to the XSF during the 12-month period ending January 15, 2010. We projected the error rate for the 6 (14 percent) of 43 cases transferred to the XSF during the 12-month period ending January 15, 2010, to the population of 57 transfers during that period, which resulted in 8 Forms 8758 and approximately \$37.3 million in transferred payments. We projected this amount over the next 5 years, which totaled 40 Forms 8758 and more than \$186 million.



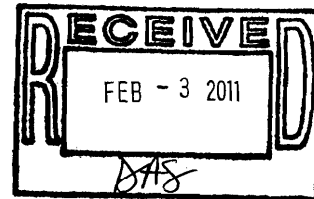
*Taxpayer Payments Were Improperly
Transferred to the Excess Collection File*

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308



JAN 28 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. *Richard Byrd*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report –Taxpayer Payments Were Improperly
Transferred to the Excess Collection File (Audit # 201030013)

We have reviewed the subject draft report and thank you for the opportunity to provide our comments. We appreciate your acknowledgement of our efforts to develop standardized procedures across all Business Operating Divisions and agree that additional measures will strengthen this program.

The Excess Collections File (XSF) primarily involves credits and payments on accounts that cannot be identified, or in which returns have not been filed. When a taxpayer has an unresolved credit balance on an account, the IRS sends a series of notices to the taxpayer's last known address of record, advising the taxpayer of the credit balance and requesting instructions on how it should be applied to their account. This notification continues until the statute expires on the account. Any payments that are received after the statute expires are transferred into the XSF. For such payments received with an amended return, the Internal Revenue Manual (IRM) requires Letter 2765C, Assessment Statute Expiration Date (ASED) Expired, to be issued to the taxpayer, advising them that the time period for the IRS to make an assessment has ended and they have two years to file a claim to have the payment refunded.

In 2005, IRS formed the Excess Collections Task Group (XSFTG) to address concerns cited in your prior report, *Enhancing Internal Controls for the Internal Revenue Service's Excess Collections File Could Improve Case Resolution* (Reference Number 2005-30-022), regarding the growth of large dollar credits in the XSF. Ten IRM procedural changes and other system changes involving operations of Accounts Management, Submission Processing, and Compliance were implemented as a result of the XSFTG. These changes help properly identify millions of dollars of unresolved credits, and affect the way accounts are worked prior to determining whether payments should be moved to XSF.



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A procedural change initiated by the XSFTG was the development and implementation of an improved research tracking system for credit balance accounts on the Integrated Data Retrieval System (IDRS) used by IRS employees to research taxpayer accounts. The system generates an Accounts Management Research transcript for virtually all credit balance accounts after 25 to 82 weeks of inactivity, depending on the type of credit and the due date of the return. At that point, the account is reviewed by an Accounts Management employee and, as mentioned above, notices are generated to the taxpayer's last known address on IDRS. The XSFTG required employees to input a new Transaction Code on IDRS to show that all research of the primary and related Taxpayer Identification Numbers were completed prior to a transfer of credits to XSF. In January 2007, the system was further enhanced to create an audit trail to record the issuance of notices requesting the taxpayer to provide information on how they want the IRS to apply the credit balance on their account.

There is a very low response rate to IRS notices involving unresolved credit balances. As a result, the process to resolve large dollar credits was changed to require additional research to locate the taxpayer. When this research identifies a telephone number, we attempt to make telephone contact with the taxpayer to determine the proper disposition of the unapplied credit. This primarily involves Business Master File accounts, which were cited in your 2005 report as the major contributing factor to the growth of the XSF.

We appreciate your review and agree opportunities remain to further improve management of XSF accounts. The Excess Collections IRM, 3.17.220, IRM 21 Customer Account Services, and IRM 25.6 Statute of Limitations, will be revised to provide additional clarification as to the proper documentation required to add payments to the XSF. We will provide training to all impacted employees to ensure understanding of the new documentation requirements. Form 8758, Excess Collection File Addition, and Letter 2765C, will be revised as requested.

We reviewed the outcome measures identified in Appendix IV and agree with your assessment. Our specific comments to your recommendations are attached. If you have any questions, please contact me, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment



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Attachment

The Director, Submission Processing, Wage and Investment Division, should:

RECOMMENDATION 1

Revise the IRM sections pertaining to the XSF to clarify between the research required by the originators of Forms 8758, and the research required by the Excess Collection function accounting technicians. In addition, the revised IRM sections should clarify the reasons to reject Forms 8758 (lack of documentation and managerial approval on transfer requests of \$100,000 or more).

CORRECTIVE ACTION

We agree with this recommendation. The Internal Revenue Manual (IRM) 3.17.220, Excess Collections File, will be revised to clarify the research required to add payments to the Excess Collections File (XSF) and clarify the reasons to reject Forms 8758, Excess Collection File Addition.

IMPLEMENTATION DATE

June 15, 2011

RESPONSIBLE OFFICIAL

Director, Submission Processing, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2

Request revisions to Form 8758 to include a dedicated line for managerial approval (signature) and date for all transfers of \$100,000 or more.

CORRECTIVE ACTION

We agree with this recommendation. Form 8758, Excess Collection File Addition, will be revised to include a dedicated line for the originator's manager's approval signature and date for all transfers of \$100,000 or more.

IMPLEMENTATION DATE

June 15, 2012

RESPONSIBLE OFFICIAL

Director, Submission Processing, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.



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The Director, Accounts Management, Wage and Investment Division should:

RECOMMENDATION 3

Emphasize the research and documentation requirements for transfers to the XSF and the requirement for managers to review and approve all transfers of \$100,000 or more.

CORRECTIVE ACTION

We agree with this recommendation. Accounts Management will work jointly with Submission Processing to review IRM 3.17.220 Excess Collections, IRM 21 Customer Account Services, and IRM 25.6 Statute of Limitations, for consistency and will make revisions as needed. Accounts Management and Submission Processing will also provide training on the IRM revisions, as needed.

IMPLEMENTATION DATE

September 15, 2011

RESPONSIBLE OFFICIAL

Director, Submission Processing, Wage and Investment Division
Director, Accounts Management, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4

Request programming changes to systemically issue Letter 2765C when taxpayers submit payments after the ASED in advance of an examination adjustment or with an amended return. In the interim, revise the respective IRM sections to instruct the issuance of Letter 2765C when payments are submitted after the ASED in advance of an examination adjustment.

CORRECTIVE ACTION

It is not possible to make an examination adjustment, or any other assessment, after expiration of the Assessment Statute Expiration Date (ASED). However, we do agree with the recommendation for a systemic solution. We will submit a Unified Work Request (UWR) for programming changes to systemically issue a letter when taxpayers submit payments after the ASED, or with an amended return. Since the requested action will be subject to funding and resource prioritization by Modernization and Information Technology Services, submission of the UWR will complete the corrective action.



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In the interim, we will clarify the existing procedures in IRM 25.6.1.8.2, Statute of Limitations, regarding the issuance of the Letter 2765C, Assessment Statute Expiration Date (ASED) Expired.

IMPLEMENTATION DATE

January 15, 2013, for submission of the UWR
September 15, 2011, for IRM clarification

RESPONSIBLE OFFICIAL

Director, Accounts Management, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 5

Request revisions to Letter 2765C to clarify how to file a claim for refund and to include Form 843 when Letter 2765C is sent to the taxpayers.

CORRECTIVE ACTION

We agree with this recommendation. We will request a revision to Letter 2765C, Assessment Statute Expiration Date (ASED) Expired, clarifying how to file a claim for refund, and include Form 843, Claim for Refund and Request for Abatement, when Letter 2765C is sent to taxpayers.

IMPLEMENTATION DATE

September 15, 2012

RESPONSIBLE OFFICIAL

Director, Accounts Management, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.